

ContextVision

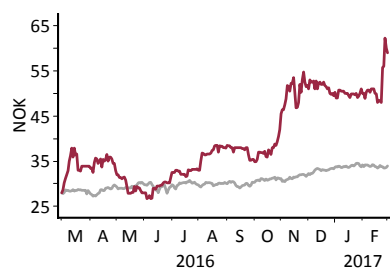
BUY

Key share data

Sector	Health Care
Reuters	COVI.OL
Bloomberg	COV NO

Market Cap (NOKm)	456
Net debt (NOKm)	-40
EV (NOKm)	417
Net debt / equity	-70%
Issued shares (m)	7.7

Share price



—ContextVision—OSEBX (Rebased)

Performance

	1m	3m	12m
COV	20%	17%	114%
OSEBX	0%	7%	21%

Upcoming events

1Q17 report	April 27, 2017
AGM	May 10, 2017
2Q17 report	August 17, 2017
3Q17 report	October 26, 2017

Norne Securities AS is a market maker in the shares of ContextVision

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AI materializing, while existing business doing impressively well

ContextVision delivered impressive 4Q results last week with record-high revenues and solid profits despite the ongoing aggressive investments into AI. We are amazed by the company's ability to continue the existing business of image enhancement at a high pace at the same time working hard on what should transform the company dramatically – moving into Digital Pathology. Therefore, we hiked our estimates and set a new TP at NOK 100/sh awaiting continuous solid existing business and exciting new opportunities within Digital Pathology to start materializing in not too distant future.

Record-high revenues and solid profits even with high spending on R&D

ContextVision (COV) released its 4Q16 report last Thursday with record-high quarterly revenues of SEK 24.9m being 21% above our projection. Sales were driven by Asian and European orders and particularly for ultrasound, which grew by an impressive 45% YoY. Adj. EBITDA (adjusted for research costs, bad debt provision and received government grant payment) came in at SEK 9.0m vs SEK 5.4m expected by us. Notably, net cash stood at SEK 43m at the end of the year, which is more than SEK 10m more than at the time of the start of aggressive R&D program in mid-2015.

New ContextVision materializing

We are now close to two years since the company announced its *quantum leap in R&D* on June 11, 2015. Since then, the company has made a major progress in the program and crystalized targeted areas (breast and prostate cancer) within the new Digital Pathology market. This market is seen reaching USD 0.7bn by 2021 with software part of it comprising about USD 0.2bn. With first products in the market likely as early as next year, we see first sales from 2019. In our model we include a modest 5% market share of the Digital Pathology software market to be reached by 2022. Notably, the company's market share within image enhancement is around 40-45%.

Upgrade to Buy on continuous outperformance and exciting years ahead

If the progress with AI (artificial intelligence) and strive to enter the Digital Pathology market is not impressive enough, COV continuously outperforms our estimates on the existing business with most notable outperformance in 4Q16. This leads to continuous profits even with aggressive R&D spend (not capitalized until certain product development criteria met). Thus, combining the very strong existing business performance with exciting years ahead entering the Digital Pathology market, we hiked our estimates (except for 2019), removed discount to DCF, set the target price at NOK 100/sh and upgrade the stock to Buy.

Estimate changes (SEKm)	4Q16		1Q17E		2017E		2018E		2019E	
	Act.	Est.	New	Old	New	Old	New	Old	New	Old
Operating revenues	24.9	20.6	21.2	19.4	86.3	82.2	89.9	87.1	117.1	120.4
EBITDA	9.0	5.4	7.1	5.4	26.8	23.3	25.2	22.4	46.7	48.5
EBITDA Margin	36%	26%	34%	28%	31%	28%	28%	26%	40%	40%
EBIT (adj)	7.6	4.3	5.8	4.3	21.5	18.7	19.9	17.8	41.4	44.0
Op. EBIT margin	31%	21%	27%	22%	25%	23%	22%	20%	35%	37%
Non-recurring items	-4.7	-3.7	-4.9	-4.2	-18.6	-17.0	-13.6	-12.0	-9.6	-8.2
EBIT	2.9	0.6	0.9	0.0	2.9	1.7	6.3	5.8	31.9	35.8
Pre-tax profit	2.9	0.6	0.9	0.0	2.9	1.7	6.3	5.8	31.9	35.8
Tax	-0.8	-0.1	-0.2	-0.0	-0.6	-0.4	-1.4	-1.3	-7.0	-7.9
Tax rate	28%	22%	22%	22%	22%	22%	22%	22%	22%	22%
Minority interests	-	-	-	-	-	-	-	-	-	-
Profit after tax	2.1	0.5	0.7	0.0	2.3	1.4	4.9	4.5	24.9	27.9
Revenue split by segment										
X-ray	2.7	2.5	2.6	2.6	10.3	10.2	10.5	10.4	10.7	10.6
Ultrasound 2D	15.9	11.3	12.6	11.2	50.5	45.7	52.5	47.6	54.1	49.0
Ultrasound 3D	3.9	3.8	2.8	2.6	12.8	14.2	14.0	16.8	14.9	18.2
Magnetic Resonance Imaging	1.7	2.6	2.7	2.6	10.6	10.4	10.8	10.6	11.0	10.9
Others (iRV, CT, Mammo)	0.7	0.4	0.5	0.4	2.0	1.7	2.1	1.7	2.1	1.8
Digital Pathology	-	-	-	-	-	-	-	-	24.3	30.0
Total	24.9	20.6	21.2	19.4	86.3	82.2	89.9	87.1	117.1	120.4

DCF model

SEKm	2017E	2018E	2019E	2020E	2021E	2022E
Revenues	86	90	117	169	194	214
EBIT	3	6	32	80	102	117
Tax on EBIT	-1	-1	-7	-18	-22	-26
NOPLAT (+)	2	5	25	62	80	91
Depreciation & amortization (+)	5	5	5	5	5	5
Capital expenditure (-)	-8	-15	-8	-4	-4	-4
Change in working capital (- or +)	1	-1	-11	-9	-4	-4
Free Cash Flow to the Firm	1	-6	11	55	76	88
NPV of FCFF	1	-5	9	37	47	49

WACC calculation		Valuation, SEKm		Assumptions	
Debt ratio	0.0%	Net debt	-43	Lt. growth	2.5%
Cost of debt (after tax)	nm	Minority interest	0	Tax rate	22%
Risk free rate	3.0%	NPV cash flow		SEK/NOK	0.93
Beta	1.2	2017-2022E	138	# shares, m*	7.6
Market risk premium	6.0%	2023E-	655	* ex. treasury shares	
Cost of equity	10.2%	Total NPV cash flow	793		
WACC	10.2%	Equity value	835		
		Value per share, SEK	109.32		
		Value per share, NOK	101.67		

Sensitivity analysis

WACC	L.t. growth				
	1.5%	2.0%	2.5%	3.5%	4.0%
8%	129.3	138.6	149.7	179.2	199.5
9%	109.5	116.1	123.7	143.2	155.9
10%	91.8	96.4	101.7	114.5	122.4
12%	73.2	76.1	79.3	86.8	91.3
15%	53.6	55.1	56.7	60.5	62.6

Profit & Loss (SEKm)	2012	2013	2014	2015	2016	2017E	2018E	2019E
Operating revenues	67.6	61.3	64.4	72.2	81.9	86.3	89.9	117.1
Operating expenses	-63.2	-51.6	-50.7	-53.1	-54.3	-59.4	-64.7	-70.4
EBITDA	4.4	9.7	13.7	19.1	27.6	26.8	25.2	46.7
Depreciation & Amortisation	-3.0	-3.5	-3.8	-4.3	-4.8	-5.3	-5.3	-5.3
EBIT (adj)	1.4	6.2	9.8	14.9	22.8	21.5	19.9	41.4
Non-recurring items	-0.7	-	-2.9	-7.9	-17.0	-18.6	-13.6	-9.6
EBIT	0.6	6.2	6.9	7.0	5.8	2.9	6.3	31.9
Net interest & other financial effects	0.2	0.2	0.1	0.0	-0.0	0.0	0.0	0.0
Pre-tax profit	0.9	6.3	7.0	7.0	5.8	2.9	6.3	31.9
Minority interests	-	-	-	-	-	-	-	-
Taxes	-0.2	-1.5	-1.6	-1.6	-1.5	-0.6	-1.4	-7.0
Profit after tax	0.6	4.9	5.4	5.3	4.3	2.3	4.9	24.9
EPS rep. (SEK)	0.08	0.63	0.70	0.69	0.55	0.29	0.64	3.21
EPS adj. (SEK)	0.16	0.63	1.03	1.50	2.30	2.17	2.01	4.18
Margins								
Operating margin	2%	10%	15%	21%	28%	25%	22%	35%
ROE	3%	11%	16%	22%	30%	27%	23%	40%
ROCE	3%	14%	20%	27%	38%	34%	29%	50%
Tax rate	28%	23%	23%	23%	26%	22%	22%	22%
Growth rates (YoY)								
Operating revenues	16%	-9%	5%	12%	13%	5%	4%	30%
EBIT (adj)	-76%	>100%	59%	52%	53%	-6%	-7%	>100%
EPS (adj)	-71%	>100%	62%	46%	53%	-6%	-7%	>100%

Cash flow (SEKm)	2012	2013	2014	2015	2016	2017E	2018E	2019E
Pre-tax profit	0.9	6.3	7.0	7.0	5.8	2.9	6.3	31.9
Depreciation and amortisation	3.8	3.5	3.9	4.3	6.2	5.3	5.3	5.3
Unrealized g/l on current investments	-0.2	0.2	-0.6	0.8	-0.0	-	-	-
Paid taxes	-1.4	-0.7	-0.3	-2.0	-3.5	-0.6	-1.4	-7.0
Other	-	-	-	-	-	-	-	-
Change in working capital	5.3	-1.8	0.2	-0.9	1.1	0.8	-0.8	-10.5
Operating cash flow (OCF)	8.5	7.7	10.3	9.2	9.5	8.4	9.4	19.7
Capital expenditures	-2.4	-3.2	-8.5	-5.4	-2.2	-7.7	-15.2	-8.2
Other cash flow from investments	-1.0	-	0.2	0.7	-0.1	-	-	-
Free Cash Flow (FCF)	5.0	4.4	2.0	4.5	7.3	0.7	-5.8	11.5
Cash flow from financing activities	-	-	-	-	-	-	-	-
Change in cash	5.0	4.4	2.0	4.5	7.3	0.7	-5.8	11.5

Balance sheet (SEKm)	2012	2013	2014	2015	2016	2017E	2018E	2019E
Goodwill	-	-	-	-	-	-	-	-
Deferred tax asset	-	-	-	-	-	-	-	-
Licences, property, plant & equipment	13.1	12.8	17.2	18.1	15.2	17.6	27.4	30.3
Other intangible assets	1.1	1.1	1.0	0.3	0.3	0.3	0.3	0.3
Non-current Assets	14.2	14.0	18.2	18.3	15.5	17.9	27.8	30.7
Inventory	0.3	0.4	0.5	0.4	0.3	0.4	0.4	0.6
Receivables	15.5	13.8	13.5	18.1	20.6	19.7	20.5	30.8
Other current assets	-	-	-	-	-	-	-	-
Cash and cash equivalents	24.7	29.2	31.1	35.6	42.9	43.6	37.8	49.3
Current Assets	40.5	43.3	45.1	54.2	63.8	63.7	58.7	80.7
Total assets	54.7	57.3	63.3	72.5	79.3	81.6	86.5	111.4
Shareholders equity	41.0	45.5	50.8	57.0	61.4	63.7	68.6	93.5
Non-controlling interests	-	-	-	-	-	-	-	-
Total equity	41.0	45.5	50.8	57.0	61.4	63.7	68.6	93.5
Deferred tax liability	-	-	-	-	-	-	-	-
Long-term interest bearing debt	-	-	-	-	-	-	-	-
Other long-term liabilities	0.1	0.4	0.8	1.2	1.5	1.5	1.5	1.5
Non-current liabilities	0.1	0.4	0.8	1.2	1.5	1.5	1.5	1.5
Current interest bearing debt	-	-	-	-	-	-	-	-
Trade payables	-	-	-	-	-	-	-	-
Other current liabilities	13.6	11.4	11.8	14.3	16.4	16.4	16.4	16.4
Current liabilities	13.6	11.4	11.8	14.3	16.4	16.4	16.4	16.4
Total liabilities	13.7	11.8	12.6	15.5	17.9	17.9	17.9	17.9
Total liabilities and equity	54.7	57.3	63.3	72.5	79.3	81.6	86.5	111.4
Working capital	15.8	14.2	14.0	18.5	20.9	20.1	20.9	31.4
Net IB debt	-24.7	-29.2	-31.1	-35.6	-42.9	-43.6	-37.8	-49.3
Capital employed	41.2	45.9	51.5	58.2	62.9	65.2	70.2	95.0
Net IB debt / equity	-60%	-64%	-61%	-62%	-70%	-68%	-55%	-53%
Equity / total assets	75%	79%	80%	79%	77%	78%	79%	84%

Share data	2012	2013	2014	2015	2016	2017E	2018E	2019E
Shares outstanding, year end (mill.)	7.737	7.737	7.737	7.737	7.737	7.737	7.737	7.737
Share price, year end (NOK)	12.00	14.00	21.90	26.40	49.50	59.00	59.00	59.00
Market cap (NOKm)	93	108	169	204	383	456	456	456
Enterprise value (NOKm)	72	81	140	169	343	416	421	411
EPS rep. (SEK)	0.08	0.63	0.70	0.69	0.55	0.29	0.64	3.21
EPS adj. (SEK)	0.16	0.63	1.03	1.50	2.30	2.17	2.01	4.18
DPS. (SEK)	-	-	-	-	-	-	-	-

Valuation	2012	2013	2014	2015	2016	2017E	2018E	2019E
EV/Sales	1.3	1.4	2.3	2.3	4.5	5.2	5.0	3.8
EV/EBITDA	19.2	9.0	11.1	8.8	13.4	16.7	18.0	9.4
EV/EBIT (adj)	62.0	14.2	15.4	11.3	16.2	20.8	22.8	10.7
P/E (adj)	89.3	23.8	23.0	17.6	23.2	29.3	31.6	15.2
P/B (excl. goodwill)	2.7	2.6	3.6	3.6	6.7	7.7	7.2	5.2

Growth (YoY)	2012	2013	2014	2015	2016	2017E	2018E	2019E
Revenues	16%	-9%	5%	12%	13%	5%	4%	30%
EBITDA	-51%	121%	41%	40%	44%	-3%	-6%	85%
EBIT (adj)	-76%	353%	59%	52%	53%	-6%	-7%	108%
Pre-tax profit (rep)	-83%	639%	11%	-1%	-17%	-49%	117%	403%
Net profit (rep)	-83%	691%	11%	-2%	-20%	-46%	117%	403%
EPS (rep)	-83%	691%	11%	-2%	-20%	-46%	117%	403%
EPS (adj)	-71%	301%	62%	46%	53%	-6%	-7%	108%

Margins	2012	2013	2014	2015	2016	2017E	2018E	2019E
EBITDA	6.5 %	15.8 %	21.2 %	26.5 %	33.7 %	31.1 %	28.1 %	39.9 %
EBIT (adj)	2.0 %	10.1 %	15.2 %	20.6 %	27.8 %	24.9 %	22.1 %	35.4 %
Pre-tax profit	1.3 %	10.4 %	10.9 %	9.6 %	7.0 %	3.4 %	7.0 %	27.2 %
Net profit	0.9 %	8.0 %	8.4 %	7.4 %	5.2 %	2.6 %	5.5 %	21.2 %

Profitability	2012	2013	2014	2015	2016	2017E	2018E	2019E
ROE	3.0 %	11.3 %	16.5 %	21.5 %	30.0 %	26.8 %	23.5 %	39.8 %
ROCE	3.3 %	14.2 %	20.1 %	27.1 %	37.6 %	33.5 %	29.4 %	50.1 %
Dividend yield	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %

Recommendation, valuation, risk and sources

Recommendation and target price

Recommendation history for ContextVision during the last 12 months:

Date	Recommendation	Target price (NOK)
02/03/2017	Buy	100.00
17/02/2017	Hold	54.00
04/11/2016	Hold	50.00
26/08/2016	Hold	41.00
28/07/2016	Buy	40.00
14/06/2016	Buy	40.00
25/04/2016	Hold	40.00
14/04/2016	Hold	40.00
24/02/2016	Hold	31.00

Valuation

To arrive at our share price target we have used a rounded result from our DCF valuation.

Risks

The main risks to our target price on ContextVision are the following:

- Slower sales growth in the operating areas, particularly in the Ultrasound segment;
- Failure to successfully complete R&D and market the new products in the portfolio, i.e. within Digital Pathology field;
- The company invests heavily in R&D and being able to capitalize on these investments, not to incur significant cost overruns etc. in the future is the key for the company's long term growth.

Sources

The sources used in the preparation of this report were: ContextVision, Macrobond, Infront and Oslo Stock Exchange.

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Norne Securities' general recommendations – Buy, Hold and Sell – are based on the expected absolute return on the financial instrument within the next 12 months, which equals to an upside to the target price, in combination with a risk profile. The target price represents the price level which the analyst expects the financial instrument to trade at within the coming 12 months. The table below shows the ranges of returns under different risk levels, based on which the recommendation is being determined:

Risk	Total return next 12 months (upside to target price)		
	Buy	Hold	Sell
Low	> 10%	2% - 10%	< 2%
Medium	> 15%	3% - 15%	< 3%
High	> 25%	5% - 25%	< 5%

In addition to the general recommendations, “Trading Buy” and “Trading Sell” recommendations can be used in the case where the analyst predicts a short term share price performance different from the twelve-month general recommendation. “Trading Buy” is given when the share price is expected to rise and “Trading Sell” is given when the share price is expected to fall in the short term (several days to several weeks horizon).

Our risk assessments range from “high risk” to “medium risk” and “low risk” and are based on a subjective assessment of the following factors: 1) volatility in the share price, 2) liquidity in the share, 3) strength of the balance sheet, 4) absolute earnings level and trend and 5) estimate risk.

TARGET PRICE AND UPDATES

Target prices may be based on one or several valuation methods, for instance, the discounted cash flow (DCF) analysis or applying “fair” pricing multiple(s) based on historical valuation or peer pricing level. Target price may not necessarily equal to the “fair value” of the financial instrument – certain discount or premium is possible due to various reasons, depending on the analyst’s view of what the price may be within the 12 months period. Norne Securities AS plans to update the recommendation based on the following events: the target price is achieved; new accounting figures are released; any significant news on the company or its industry is announced.

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POTENTIAL CONFLICTS OF INTEREST

Norne Securities AS is a market maker in the shares of ContextVision.

This report has been presented to the issuer before dissemination for a check of factual information. Amendments of factual information have not been made following this.

Share holdings of Norne employees in ContextVision:

Responsible analyst(s)	0
All Norne analysts	0
All Norne employees	0
Norne Securities AS	0

The overview of share holdings is updated continuously. A list of total share holdings of the Norne Securities' employees and the date of last overview can be found on <https://www.norne.no/compliance/>. Shareholdings that Norne Securities AS owns as a result of own-account trading that is part of its investment services operations (such as market making) are not included in the table above.

Distribution of Norne Securities' recommendations during three months up till December 31, 2016:

	Buy	Hold	Sell
Total recommendations	75	31	4
% of total	68%	28%	4%
Corporate clients*	16	15	2
% of corporate clients*	48%	45%	6%

* Includes publicly disclosed not immaterial investment banking services or issues of financial instruments where Norne Securities AS has been lead manager or co-lead manager, and market making clients during the 12 months prior to the overview date.

Note: In the table above, Trading Buy recommendation is treated as Buy, and Trading Sell is treated as Sell.

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